

Message Text

CONFIDENTIAL

PAGE 01 MONTEV 03182 081249Z

43

ACTION ARA-10

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TAGS: ECON, EFIN, UY

SUBJ: FINANCIAL RATE SINKS

REF: MONTEVIDEO 2836

1. SUMMARY: ON OCTOBER 21 AND 22 THE LIBERALIZED FINANCIAL
FX RATE FELL SHARPLY FROM A HIGH POINT OF ABOUT 3050 TO 2300 PESOS
PER US\$. SINCE THEN THE RATE HAS HELD ALMOST STEADY AT ABOUT
2400 AND WE ARE TOLD THE BANKS ARE ACTING IN CONCERT TO
MAINTAIN THE RATE AROUND THIS LEVEL. ALTHOUGH IT IS NOT CLEAR
EXACTLY HOW IT CAME ABOUT, THE FREE FLOATING FINANCIAL MARKET
IS NOW, AT LEAST TEMPORARILY, NOT FUNCTIONING. END SUMMARY.

2. FOLLOWING THE LIBERALIZATION OF THE FINANCIAL FX RATE
SEPTEMBER 25 (SEE REFTTEL), THE PESO/DOLLAR EXCHANGE ROSE
STEADILY TO ABOUT 3050 ON OCTOBER 18, AN INCREASE OF 42 PERCENT IN
JUST OVER THREE WEEKS. THE SHARP FALL (24 PERCENT) ON THE FOLLOWING
MONDAY AND TUESDAY EFFECTIVELY BROKE SPECULATIVE WITHHOLDING
OF DOLLAR SALES WHICH HAD CHARACTERIZED THE MARKET EARLIER. THE
ACCUMULATED BACKLOG OF DOLLAR PURCHASES ORDERS WAS QUICKLY
LIQUIDATED AS SEVERAL BANKS SOLD OFF THEIR FOREIGN CURRENCY
POSITIONS. AFTER TOUCHING 2300/\$, THE RATE RECOVERED TO ABOUT
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 MONTEV 03182 081249Z

2400, WHERE IT HAS SINCE REEMINED.

3. THE RATE HAS NOW BEEN VIRTUALLY STABLE FOR ONE WEEK, WITH FEW TRANSACTIONS AND ONCE AGAIN A BACKLOG OF UNFILLED FX PURCHASE ORDERS IS BUILDING UP. THERE ARE SOME REPORTS OF AN INCREASE IN ILLEGAL BLACK MARKET TRANSACTIONS AT BETWEEN 2500-2550/\$. THE PRIVATE BANKS MEANWHILE HAVE BEEN BUYING DOLLARS TO RECLUP THEIR FX POSITION, AND IN THE PROCESS SOME HAVE TURNED A TIDY PROFIT.

4. THE CURRENT STABILITY IS CLEARLY ARTIFICALLY INDUCED SINCE THE MARKET IS NOT MATCHING BUYERS AND SELLERS NOR PREVENTING ACTIVITY IN THE PARALLEL MARKET. INDEED, WE ARE RELIABLY TOLD THAT DAILY INSTRUCTIONS ARE BEING ISSUED THROUGH THE BANKERS' ASSOCIATION TO HOLD THE RATE. THESE MAY ALSO HAVE BEEN THE CAUSE OF LAST WEEK'S DECLINE, BUT THERE ARE CONFLICTING OPINIONS ON THIS.

5. PRIOR TO THE BREAK IN THE FINANCIAL FX MARKET ON OCTOBER 21, MANY PEOPLE HERE FELT THE DOLLAR RATE HAD BECOME OVERVALUED AS A RESULT OF SPECULATIVE PRESSURES. IN ESTABLISHING THE NEW FINANCIAL MARKET, THE CENTRAL BANK HAD SPECIFICALLY RESERVED THE RIGHT TO INTERVENE TO COUNTER SPECULATIVE MOVEMENTS. ALTHOUGH THE CB VIGOROUSLY DENIES THAT IT HAS INTERVENED IN THE MARKET DURING RECENT WEEKS, IT IS POSSIBLE THAT THE INTERVENTION THAT DID TAKE PLACE WAS CONCEIVED OF AS ANTI-SPECULATIVE. THE BANKER'S ASSOCIATION MET ON OCTOBER 21 AND DISCUSSED THE SITUATION IN TERMS SUGGESTING THAT THE RATE SHOULD COME DOWN IF FORMAL CONTROLS WERE TO BE AVOIDED. IT IS ALSO BEING SAID THAT THE BREAK HERE WAS INITIALLY TRIGGERED BY THE DECLINE OF THE DOLLAR RATE IN ARGENTINA FOLLOWING THE CHANGE OF ECONOMY MINISTER THERE. SOME SOURCES BELIEVE GUIDANCE TO THE BANKERS' ASSOCIATION NOW COMES FROM MILITARY ELEMENTS OPERATING INDEPENDENTLY OF THE CB.

6. HOWEVER IT CAME ABOUT, IT IS EVIDENT THAT THE PRESENT MANAGED RATE IS A STEP AWAY FROM THE MINISTER OF ECONOMY VEGH'S DECLARED POLICY OF A FREELY FLOATING FX MARKET. IT IS TRUE THAT THE NEW STABILIZED RATE IS CURRENTLY CLOSER TO THE BLACK MARKET RATE-WHAT MAY BE INFERRED AS A QUASI EQUILIBRIUM RATE. THE LOCAL IMF REPRESENTATIVE HAS ADVISED US THAT IF THIS CONTINUES

CONFIDENTIAL

PAGE 03 MONTEV 03182 081249Z

TO BE SO, HE WOULD CONSIDER THE CONDITION OF THE FINANCIAL MARKET TO BE A MINOR MATTER WHICH SHOULD NOT AFFECT THE FORTHCOMING STANDBY NEGOTIATIONS WITH THE GOU. MUCH WILL DEPEND ON THE COURSE OF THE BLACK MARKET RATE, NOW BENEFITTING FROM AN UNPRECEDENTEDLY LARGE INFLOW OF ARGENTINE MONEY, ABOUT WHICH WE UNDERSTAND THE GOA IS INCREASINGLY CONCERNED.

7. THE PRESENT SITUATION MAY BE ONLY TEMPORARY. WE UNDERSTAND

SOME BANKS ARE ALREADY CHAFING UNDER THE CURRENT SYSTEM OF SELF-REGULATION THROUGH THE ASSOCIATION. THERE ARE REPORTS AND OTHER INDICATIONS THAT HEATED DISCUSSIONS ARE CONTINUING WITHIN THE GOVERNMENT AND THE MILITARY OVER THE ENTIRE EXCHANGE RATE POLICY. VEGH VILLEGAS IS KNOWN TO BE PUSHING FOR MORE AND LARGER MINIDEVALUATIONS OF THE COMMERCIAL RATE, LEADING TO A UNIFICATION OF THE TWO MARKETS AT SOME INTERMEDIARY LEVEL, WHILE OTHERS, APPARENTLY INCLUDING THE CB, HESITATE TO FACE THE INFLATIONARY IMPACT. A RETURN TO A FLOATING MARKET COULD ACCOMPANY THESE CHANGES.
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